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charged thereafter. Any partial prepayment made on other than an installment due date need not be credited until the next following installment due date or 30 days after such prepayment, whichever is earlier. The holder and the debtor may agree at any time that any prepayment not previously applied in satisfaction of matured installments shall be reapplied for the purpose of curing or preventing any subsequent default.

(Authority: 38 U.S.C. 3703(d))

§ 36.4312 Interest rates.

(a) In guaranteeing or insuring loans under 38 U.S.C. chapter 37, the Secretary may elect to require that such loans either bear interest at a rate that is agreed upon by the veteran and the lender, or bear interest at a rate not in excess of a rate established by the Secretary. The Secretary may, from time to time, change that election by publishing a notice in the FEDERAL REGISTER. However, the interest rate of a loan for the purpose of an interest rate reduction under 38 U.S.C. 3710(a)(8), (a)(9)(B)(i), or (a)(11) must be less than the interest rate of the VA loan being refinanced. This paragraph does not apply in the case of an adjustable rate mortgage being refinanced under 38 U.S.C. 3710(a)(8), (a)(9)(B)(i), or (a)(11) with a fixed rate loan.

(Authority: 38 U.S.C. 3703, 3710)

(b) For loans bearing an interest rate agreed upon by the veteran and the lender, the veteran may pay reasonable discount points in connection with the loan. The discount points may not be included in the loan amount, except for interest rate reduction refinancing loans under 38 U.S.C. 3710(a)(8), (a)(9)(B)(i), and (a)(11). For loans bearing an interest rate agreed upon by the veteran and the lender, the provisions of § 36.4813(d)(6) and (d)(7) do not apply.

(Authority: 38 U.S.C. 3703, 3710)

(c) Except as provided in § 36.4815, interest in excess of the rate reported by the lender when requesting evidence of guaranty or insurance shall not be payable on any advance, or in the event of any delinquency or default: Provided, that a late charge not in excess of an

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amount equal to 4 percent on any installment paid more than 15 days after due date shall not be considered a violation of this limitation.

(Authority: 38 U.S.C. 3710)

(d) Effective October 1, 2003, adjustable rate mortgage loans which comply with the requirements of this paragraph (d) are eligible for guaranty.

(1) *Interest rate index.* Changes in the interest rate charged on an adjustable rate mortgage must correspond to changes in the weekly average yield on one year (52 weeks) Treasury bills adjusted to a constant maturity. Yields on one year Treasury bills at “constant maturity” are interpolated by the United States Treasury from the daily yield curve. This curve, which relates the yield on the security to its time to maturity, is based on the closing market bid yields on actively traded one year Treasury bills in the over-the-counter market. The weekly average one year constant maturity Treasury bill yields are published by the Federal Reserve Board of the Federal Reserve System. The Federal Reserve Statistical Release Report H. 15 (519) is released each Monday. These one year constant maturity Treasury bill yields are also published monthly in the Federal Reserve Bulletin, published by the Federal Reserve Board of the Federal Reserve System, as well as quarterly in the Treasury Bulletin, published by the Department of the Treasury.

(2) *Frequency of interest rate changes.* Interest rate adjustments must occur on an annual basis, except that the first adjustment may occur no sooner than 36 months from the date of the borrower’s first mortgage payment. The adjusted rate will become effective the first day of the month following the adjustment date; the first monthly payment at the new rate will be due on the first day of the following month. To set the new interest rate, the lender will determine the change between the initial (*i.e.*, base) index figure and the current index figure. The initial index figure shall be the most recent figure available before the date of mortgage loan origination. The current index figure shall be the most recent index figure available 30 days before the date of each interest rate adjustment.

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(3) *Method of rate changes.* Interest rate changes may only be implemented through adjustments to the borrower's monthly payments.

(4) *Initial rate and magnitude of changes.* The initial contract interest rate of an adjustable rate mortgage shall be agreed upon by the lender and the veteran. Annual adjustments in the interest rate shall correspond to annual changes in the interest rate index, subject to the following conditions and limitations:

(i) No single adjustment to the interest rate may result in a change in either direction of more than one percentage point from the interest rate in effect for the period immediately preceding that adjustment. Index changes in excess of one percentage point may not be carried over for inclusion in an adjustment in a subsequent year. Adjustments in the effective rate of interest over the entire term of the mortgage may not result in a change in either direction of more than five percentage points from the initial contract interest rate.

(ii) At each adjustment date, changes in the index interest rate, whether increases or decreases, must be translated into the adjusted mortgage interest rate, rounded to the nearest one-eighth of one percent, up or down. For example, if the margin is 2 percent and the new index figure is 6.06 percent, the adjusted mortgage interest rate will be 8 percent. If the margin is 2 percent and the new index figure is 6.07 percent, the adjusted mortgage interest rate will be 8 1/8 percent.

(5) *Pre-loan disclosure.* The lender shall explain fully and in writing to the borrower, at the time of loan application, the nature of the obligation taken. The borrower shall certify in writing that he or she fully understands the obligation and a copy of the signed certification shall be placed in the loan folder and furnished to VA upon request.

(i) The fact that the mortgage interest rate may change, and an explanation of how changes correspond to changes in the interest rate index;

(ii) Identification of the interest rate index, its source of publication and availability;

(iii) The frequency (*i.e.*, annually) with which interest rate levels and monthly payments will be adjusted, and the length of the interval that will precede the initial adjustment; and

(iv) A hypothetical monthly payment schedule that displays the maximum potential increases in monthly payments to the borrower over the first five years of the mortgage, subject to the provisions of the mortgage instrument.

(6) *Annual disclosure.* At least 25 days before any adjustment to a borrower's monthly payment may occur, the lender must provide a notice to the borrower which sets forth the date of the notice, the effective date of the change, the old interest rate, the new interest rate, the new monthly payment amount, the current index and the date it was published, and a description of how the payment adjustment was calculated. A copy of the annual disclosure shall be made a part of the lender's permanent record on the loan.

(Authority: 38 U.S.C. 3707A)

§ 36.4313 Charges and fees.

(a) No charge shall be made against, or paid by, the borrower incident to the making of a guaranteed or insured loan other than those expressly permitted under paragraph (d) or (e) of this section, and no loan shall be guaranteed or insured unless the lender certifies to the Secretary that it has not imposed and will not impose any charges or fees against the borrower in excess of those permissible under paragraph (d) or (e) of this section. Any charge which is proper to make against the borrower under the provisions of this paragraph may be paid out of the proceeds of the loan: Provided, That if the purpose of the loan is to finance the purchase or construction of residential property the costs of closing the loan including the pro rata portion of the ground rents, hazard insurance premiums, current year's taxes, and other prepaid items normally involved in financing such transaction may not be included in the loan.

(b) Except as provided in this subpart, no brokerage or service charge or their equivalent may be charged against the debtor or the proceeds of